No. 93-1504

In The

Supreme Court of the United States

October Term, 1993

THE CELOTEX CORPORATION,

Petitioner,

v.

BENNIE EDWARDS and JOANN EDWARDS,

Respondents.

On Writ Of Certiorari
To The United States Court Of Appeals
For The Fifth Circuit

REPLY BRIEF FOR PETITIONER

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RULE 29.1 STATEMENT

Celotex's statement for purposes of this Court's Rule 29.1, which appears at Brief for Petitioner at ii, remains accurate.

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The Edwardses concede that the judgment of the Fifth Circuit must be reversed if the Florida bankruptcy court had subject matter jurisdiction to issue its stay of execution upon Celotex's supersedeas bonds. *See* Brief for Respondents at 16, 19-48.

Indeed, it is undisputed that Federal Rule of Civil Procedure 65.1 does not permit enforcement of a bond, where a court in another circuit has issued an order pursuant to 11 U.S.C. §105(a) staying enforcement, *unless that stay is subject to collateral attack*. *See* Brief for Respondents at 16, 19-48. In this case, the only ground advanced in support of the Edwardses' admitted collateral attack is that the Florida bankruptcy court lacked subject matter jurisdiction to issue its stay. *See id.* at 16, 19, 21-48.

The Edwardses' argument that the bankruptcy court lacked subject matter jurisdiction is without merit. The

III. WHILE THIS COURT SHOULD NOT REACH THE MERITS OF THE §105(a) STAY VIA A COLLATERAL ATTACK, THE BANKRUPTCY COURT DID NOT ABUSE ITS DISCRETION IN ISSUING THE STAY

As described above, this case involves an impermissible collateral attack on the Florida bankruptcy court's §105(a) stay. For this reason, this Court should not address the merits of the stay at this time, just as the Fifth Circuit should not have reviewed the merits.

This point is of particular importance to judicial administration, because the record regarding the §105(a) stay was not before the Texas district court below. The Texas district court held no hearings and received no evidence regarding the §105(a) stay;[13] in contrast, the Florida bankruptcy court held hearings and received voluminous evidence. *Celotex II*, 140 B.R. at 914. Accordingly, the record required for informed appellate review of the §105(a) stay – and for this Court to use in setting standards for the future employment of §105(a) – is where one would expect it to be, in the Florida bankruptcy court.[14]

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[13] This simply illustrates that the Fifth Circuit's decision to review the merits of the stay by collateral attack is bad law and worse policy. The Fifth Circuit disapprovingly noted that materials relevant to a decision to *issue* the §105(a) stay were not before it. *Edwards II*, 6 F.3d at 320 n.7. However, *this very evidence* was in the record before the bankruptcy court. *Compare Edwards II, id., with Celotex II*, 140 B.R. at 914 (discussion of bonds and agreements with sureties placed in evidence). One of the reasons for the rule against collateral attack, of course, is that the court in which the collateral attack occurs does not have the benefit of the full record made in the court which issued the order. That is precisely what happened in this case.

[14] Should the Court wish, Celotex will make that record (which is voluminous) available to the Court.

The power of the bankruptcy court to issue the §105(a) stay has been demonstrated at length in Parts I.A.2.a. and c. of this Argument, and that discussion will not be repeated here. Celotex respectfully refers the Court to that discussion. Below, Celotex will briefly address the propriety of the stay on its merits in the event the Court determines that it is appropriate to review the merits.

Preliminarily, it is important to note that the abuse of discretion standard should be used to review the §105(a) stay. *See Doran v. Salem Inn, Inc.*, 422 U.S. 922, 931-32 (1975) (abuse of discretion standard should be used to review merits of preliminary injunction); *Brown v. Chote*, 411 U.S. 452, 457 (1973) (same); *American Imaging Servs., Inc. v. Eagle-Picher Indus., Inc. (In re Eagle-Picher Indus., Inc.)*, 963 F.2d 855, 858 (CA6 1992) (abuse of discretion standard to be used in reviewing bankruptcy court's §105(a) stay of proceedings against debtor's officers); *Commonwealth Oil Ref. Co. v. United States Envtl. Protection Agency (In re Commonwealth Oil Ref. Co.)*, 805 F.2d 1175, 1188 (CA5 1986) (abuse of discretion standard used to review denial of §105(a) stay), *cert. denied*, 483 U.S. 1005 (1987).[15] In this case, it is beyond dispute that there was no abuse of discretion.

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[15] In *Edwards II*, the Fifth Circuit, in reviewing the advisability of the stay, never addressed the standard of review which it was to employ. To the extent that it was considering an appeal of a collateral attack, the Fifth Circuit should have reviewed the record for the existence of the three collateral attack exceptions which this Court set forth in *Walker, GTE Sylvania* and similar decisions. To the extent that it was reviewing the merits of the §105(a) stay, the Fifth Circuit should have employed the abuse of discretion standard it used in *Commonwealth Oil*.

A. The Bankruptcy Court's §105(a) Stay, Entered To Protect Celotex's Reorganization And All Of Its Creditors, Was Justified

The critical role of Celotex's insurance and the supersedeas bonds in Celotex's bankruptcy case has been explained in detail in the Statement of the Case. The bonded judgments alone represented $70 million of assets otherwise available for creditors on the petition date. The bankruptcy court must determine whether some or all of those assets can be distributed to other creditors as a result of the bankruptcy.

The bankruptcy court's powers to avoid transfers and subordinate or disallow claims – under appropriate factual circumstances – are plain. Transfers of assets related to bonded judgments which fall within the preference period can and should be set aside as preferential. Transfers of assets related to bonded judgments which are constructively fraudulent conveyances (*e.g.*, a transfer on account of punitive damages is not for reasonably equivalent value, since the recipient gave *no* value), can and should be set aside as constructively fraudulent transfers under federal and state law. (The verdict, entry of judgment and posting of the bond in the Edwardses' civil tort action are all within Florida's four year fraudulent conveyance period, Fla. Stat. Ch. 726.110(1)-(2)). Moreover, punitive damage awards can and should be subordinated under 11 U.S.C. §510(c), 11 U.S.C. §726(a)(4) and/or the cases cited in footnote 12 of *Celotex I*. 128 B.R. at 484 n.12. Finally, executory contracts with the sureties can be rejected under 11 U.S.C. §365. As the bankruptcy court held, these debtor-creditor issues should be resolved by the bankruptcy court before the $70 million is distributed.[16] *Celotex I*, 128 B.R. at 484. If Celotex's

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[16] In making this determination, the bankruptcy court employed the proper standard for the grant of injunctive relief.

supersedeas bonds are executed upon, as a practical matter the bankruptcy court will lose its ability to grant effective relief with respect to these issues.

When Celotex and Carey Canada filed for relief in bankruptcy, there were approximately 140,000 asbestos claimants who were not the beneficiaries of supersedeas bonds. *Id.* at 482. As previously noted, these claimants will likely collect only a fraction of their compensatory damages – and no punitive damages. There were also approximately 100 supersedeas bonds, collateralized by nearly $70 million worth of Celotex's assets, *id.*; *Celotex II*, 140 B.R. at 914 (explaining collateralization), posted to benefit 229 judgment claimants. Under these circumstances, as the Fourth Circuit's analysis in *Willis* illustrates, *see* 978 F.2d at 149-50, it is not an abuse of discretion for the bankruptcy court to stay execution on the bonds until it can resolve the issues currently before it for decision. Indeed, faced with these facts, it would be an abuse of discretion *not* to stay execution.

B. The Fifth Circuit's Decision Overlooks The Important Bankruptcy Policies That The §105(a) Stay Promoted

The *Edwards II* decision completely disregards the bankruptcy policy that similarly situated creditors must

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See Celotex II, 140 B.R. at 914-16 (discussing and applying the Eleventh Circuit's four part standard for such relief). Celotex refers the Court to that discussion for the details regarding how the standard is met here. *See id.* Moreover, the Sixth Circuit in *Eagle-Picher* held that, in this context, the bankruptcy court need not even give any significant weight to the factor involving the debtor's ultimate likelihood of success on the merits. 963 F.2d at 859-60. Here, of course, the bankruptcy court found that Celotex made a clear evidentiary showing with regard to this factor, as well as the other three factors. *Celotex II*, 140 B.R. at 914-16. These factual findings are not clearly erroneous and thus cannot be set aside on appeal. Fed. R. Bankr. P. 8013.

be treated alike. *See, e.g., Phoenix Mut. Life Ins. Co. v. Greystone III Joint Venture (In re Greystone III Joint Venture)*, 995 F.2d 1274, 1277 (CA5 1991) (discussing need to treat similarly situated creditors alike), *cert. denied*, 113 S. Ct. 72 (1992). Because the Fifth Circuit improperly allowed a collateral attack to succeed while the Fourth Circuit did not, Celotex's bonded judgment creditors with cases pending in the Fifth Circuit were permitted to recover upon their judgments immediately, while in the Fourth Circuit, bonded judgment creditors were required to seek relief from the Florida bankruptcy court.

Public policy mandates a centralization of authority to govern debtor-creditor relationships in a bankruptcy case. The bankruptcy court must act in the interest of the debtor's reorganization and protect the rights of *all* creditors wherever located. Thus, the bankruptcy court often will view the equities of a given situation differently from a court presiding over an isolated proceeding. The Fifth Circuit concluded, based upon a plainly inadequate record, that the equities favored a ruling that allowed two plaintiffs before it to execute upon a supersedeas bond to collect an award of punitive damages against Celotex. In so doing, the Fifth Circuit made a judgment which the Florida bankruptcy court was better positioned and qualified, as well as exclusively authorized, to make. This judgment must be made with all creditors – not just the Edwardses – in mind.

The *Edwards II* decision also overlooks the fact that the §105(a) stay merely maintains the status quo for a time and does not destroy any rights to the supersedeas bonds. The stay enables the bankruptcy court to determine whether the transfers to procure the bonds can be avoided or the claims subordinated or disallowed. It may also enable the bankruptcy court to confirm a plan of reorganization that may alter or otherwise modify payment obligations as to the affirmed judgments. *See* 11 U.S.C. §1123. Such bankruptcy court actions could permit

the use of Celotex's collateral to benefit all creditors. Finally, the *Edwards II* decision intruded upon the bankruptcy court's exclusive jurisdiction over Celotex's property, the cash that secures Celotex's supersedeas bonds, and the determination of what may constitute property by virtue of the avoiding powers available in a bankruptcy. *See* 28 U.S.C. §1334(d); *see generally United States v. Whiting Pools, Inc.*, 462 U.S. 198 (1983).

The bankruptcy court is in the best position to address these complex disputed issues via a full and fair determination on the merits. *See, e.g., Celotex II*, 140 B.R. at 917 (ordering Celotex to initiate an adversary proceeding against the beneficiaries of, and sureties on, supersedeas bonds). The Fifth Circuit's decision attempts to "dispense justice" by divesting the bankruptcy court of its exclusive jurisdiction to make determinations which are *critical* to Celotex's reorganization effort. Indeed, the Fifth Circuit's decision, if affirmed, would ensure that *no court* will address these issues, on the merits, as to the Edwardses.

C. The Edwardses' Expectations Regarding The Supersedeas Bond, While Not Controlling, Have Not Yet Been Disappointed

Instead of acknowledging the many reasons favoring deference to the bankruptcy court's injunctive order, the court in *Edwards II* spoke in poignant terms about its duty to see that the Edwardses' expectations regarding Celotex's supersedeas bond were not dashed. *See Edwards II*, 6 F.3d at 320.

The Edwardses' expectations, while worthy of consideration, simply are not controlling. This Court has recognized that bankruptcy affects the settled expectations of creditors and third-parties alike. *See Whiting Pools*, 462 U.S. at 206 ("As does all bankruptcy law,

§542(a) modifies the procedural rights available to creditors to protect and satisfy their liens."); *NLRB v. Bildisco & Bildisco*, 465 U.S. at 532 ("But the filing of the petition in bankruptcy means that the collective-bargaining agreement is no longer immediately enforceable, and may never be enforceable again."). The postponement of enjoyment, or modification, of the Edwardses' pre-petition "rights" is far from unique in the Celotex bankruptcy or unusual in bankruptcies in general. *See Whiting Pools*, 462 U.S. at 206.

As matters stand today, the Edwardses are in no worse position than the day Celotex filed for bankruptcy. The Florida bankruptcy court's §105(a) stay does not discharge Celotex's supersedeas bond, nor does the stay reduce the amount of the bond. Indeed, in the exercise of its discretion to balance the claims of competing creditors, the bankruptcy court has directed Celotex to establish a reserve account as adequate protection for the bonded claimants, including the Edwardses. *Celotex II*, 140 B.R. at 917. This is an appropriate balancing of the equities.

The exact benefit that the Edwardses will ultimately obtain from Celotex's supersedeas bond has not yet been determined. However, the Edwardses' expectations regarding the bond have not yet been disappointed. The Edwardses have simply been put on hold pending resolution of the important bankruptcy issues implicated here. Meanwhile, their interests have been protected. This is eminently reasonable under difficult circumstances. It is not an abuse of discretion.

Accordingly, in the event that this Court were to conclude that the Fifth Circuit appropriately reached or could reach the merits of the bankruptcy court's §105(a) stay, this Court should hold that the bankruptcy court did not abuse its discretion in issuing its stay.

CONCLUSION

For the foregoing reasons, the judgment of the United States Court of Appeals for the Fifth Circuit should be reversed.

Respectfully submitted,

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